

Draft decision

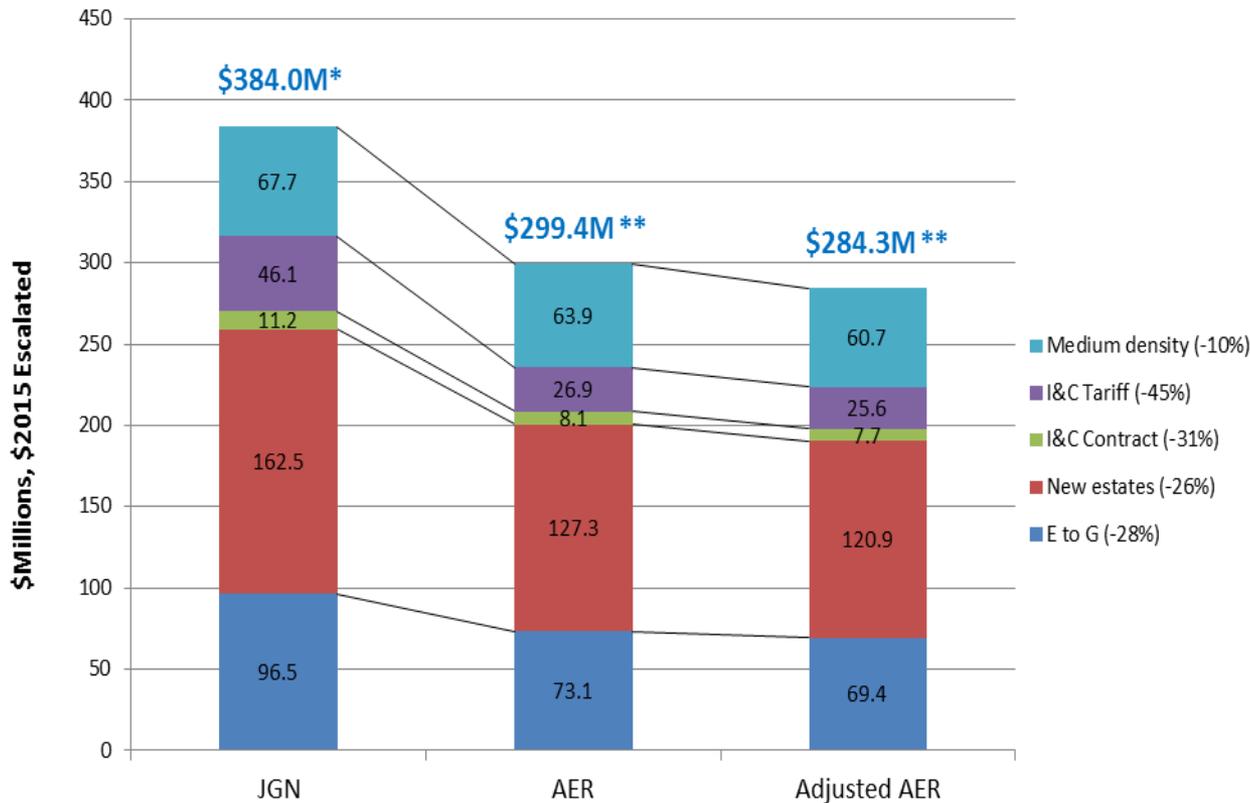
Market expansion
capex

Objective

- Share our initial views on the draft decision on market expansion (**ME**) capex.
- Facilitate further engagement on this issue in January 2015

Material reduction to ME capex

Market expansion capex - JGN proposal vs AER draft decision



Our proposal

\$2,039 / connection

Draft decision

\$1,535 / connection

* \$384.0M is JGN Proposal for ME excluding ME projects, direct OH and RPM, which is equivalent to AER DD Table 6-5 \$384.1M with ME projects removed.

** \$299.4M from AER DD workings which is stated to include direct OH from the historical unit rates. This corresponds to AER DD Table 6-2 \$299.6M with ME projects removed. \$284.3M excludes \$15.17M of direct OH which AER allocated to ME.

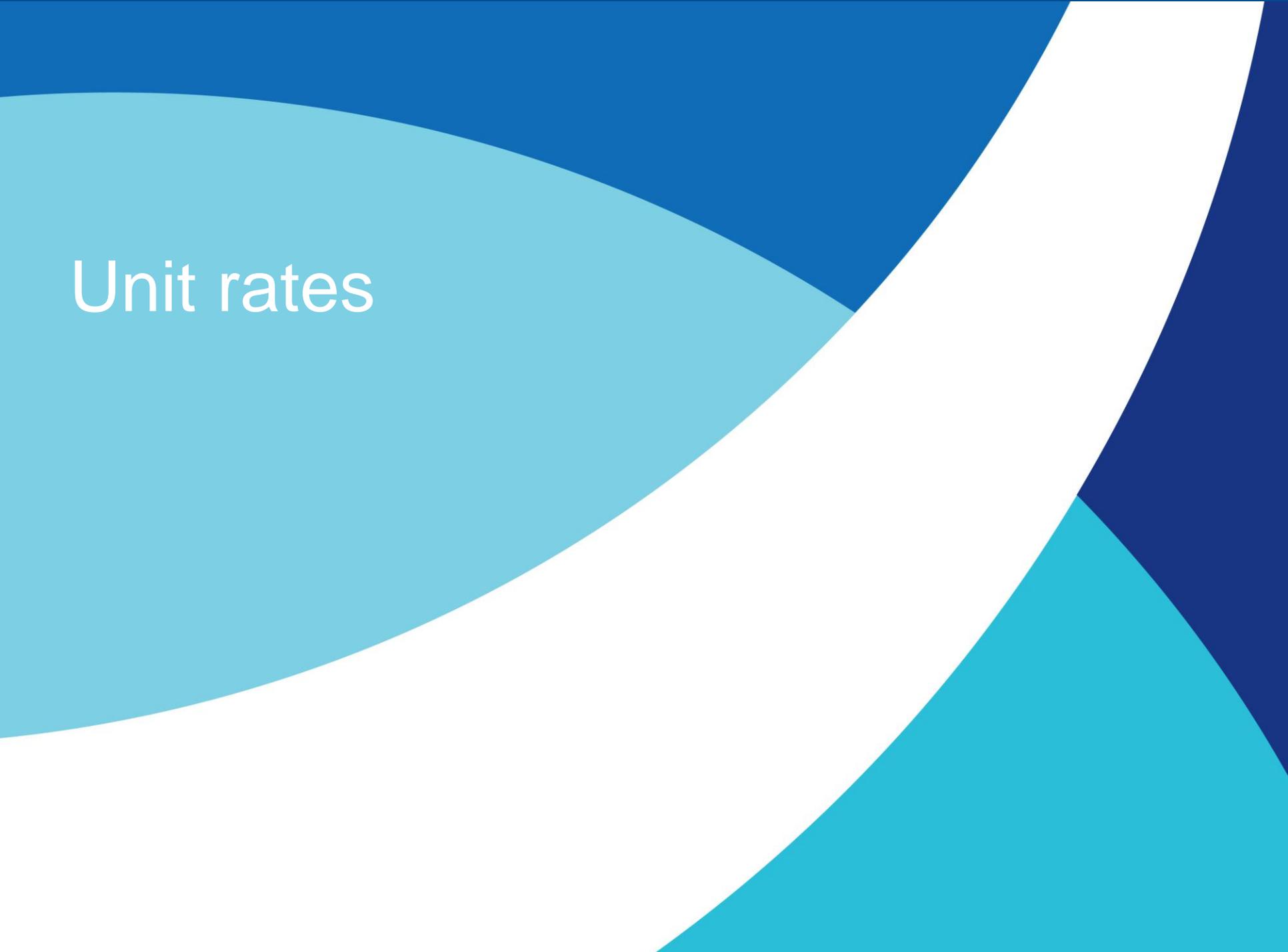
Areas of agreement

We agree on key methodological choices

- Total ME capex forecast is the aggregate of distinct categories of expenditure
 - New estates
 - Medium-density / high-rise
 - E-G conversions
 - I&C tariff (commercial customers)
 - I&C contract (large industrial customers)
- Mains, services and meters are the key components of connections, and it is important to cost these separately
- There are different ratios of mains, services and meters for each ME category, and this should be taken into account.

Our initial concerns

- Draft decision unit rates are unsustainable
 - Materially lower than market-tested contract rates which the AER has accepted as efficient
 - Materially lower than those we forecast to pay, and are currently paying, under those efficient contracts
 - Materially lower than those approved by the AER for current 2011-15 period
- Potential modelling errors
- Submission material overlooked

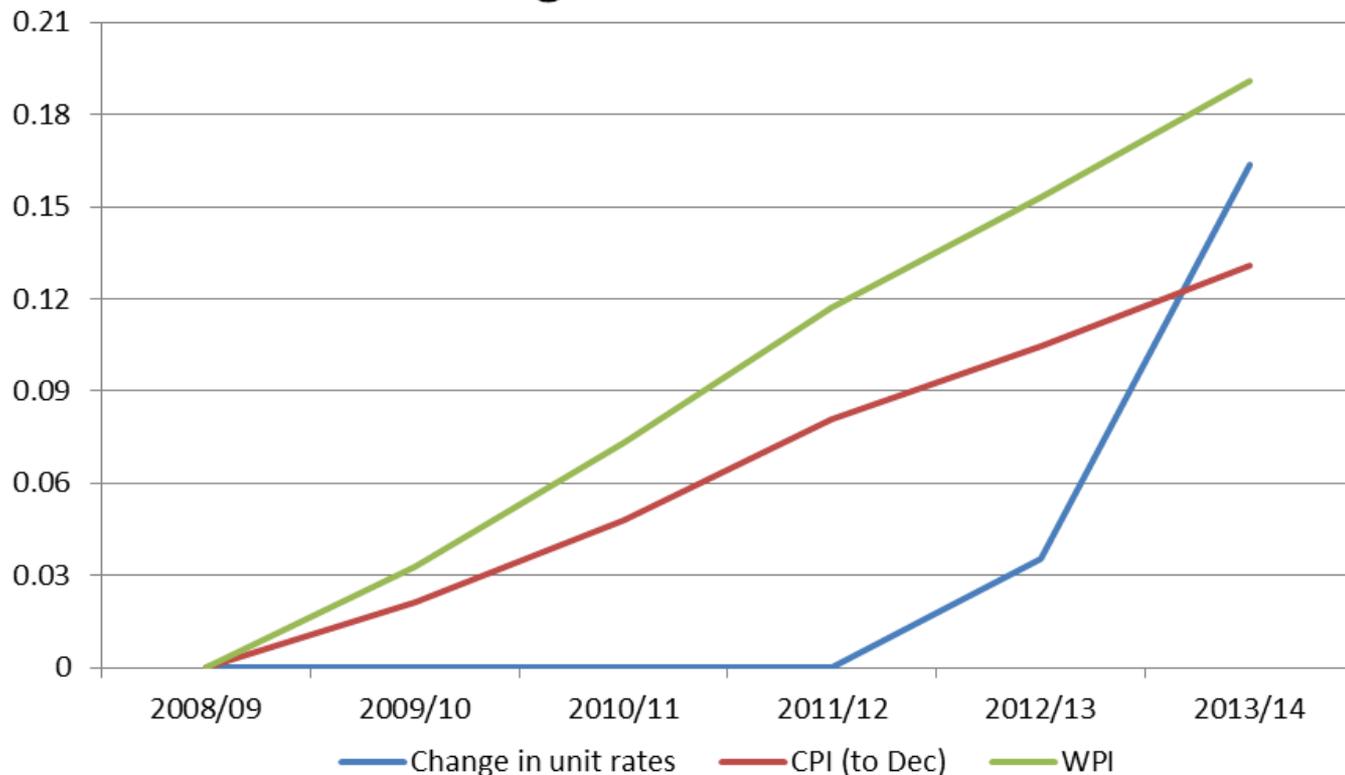
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Unit rates

Unit rates – historical rates are unsustainable

We can't purchase historical rates

Unit rate growth v market indices



Was this considered?

This was acknowledged, but then ignored

Market-tested unit rates not used in draft decision

JGN established new contracts for routine construction in October 2012. As it was a competitive tender price, we are satisfied that the unit rates drawn from these contracts which form the basis of estimates used in JGN's proposed capex are efficient.

Versus

We therefore calculated the connection unit rates using actual data between 2008 and 2013.

Draft decision unit rates below 2013/14 expectations (which reflect those efficient contracts)

Efficient expectations v draft decision (exc. ME projects)

	2013/14 forecast (per our proposal)	Draft decision annual average	Sense check
Total ME (\$2015)	\$78.6M	\$56.8M	●
New connections forecast (#)	34,767	37,030	
Average cost / connection (\$2015)	\$2,261	\$1,535	

Notes: excludes direct OH and RPM, 2013/14 connections included 842 E to G connections, which are omitted in AER DD Table 6-9.

Efficient reality closer to our proposal than draft decision

2013/14 actuals v our proposal v draft decision (exc. ME projects)

\$k, \$2015, direct un-escalated cost / connection	2013/14 actuals	Our proposal	Draft decision	Sense check
E to G			[c-i-c]	●
New estates				●
I&C Contract (\$k/RV)				●
I&C				●
Medium density				●

Note: excludes direct OH and RPM

Draft decision rates significantly lower than previous AER-approved rates

2016-20 draft decision v 2011-15 final decision (exc. ME projects)

	Draft decision 2016-20	Final decision 2011-15	Variance	Compare with actual/forecast for 2011-15	Sense check
Total ME (\$2015)	\$284.3M	\$391.4M	- \$107.1M	\$322.9M	●
New connections forecast (# of new meters)	185,151	187,918	- 2,767	167,506	
Average cost per connection (\$2015)	\$1,535	\$2,083	- \$548	\$1,928	

Sources:

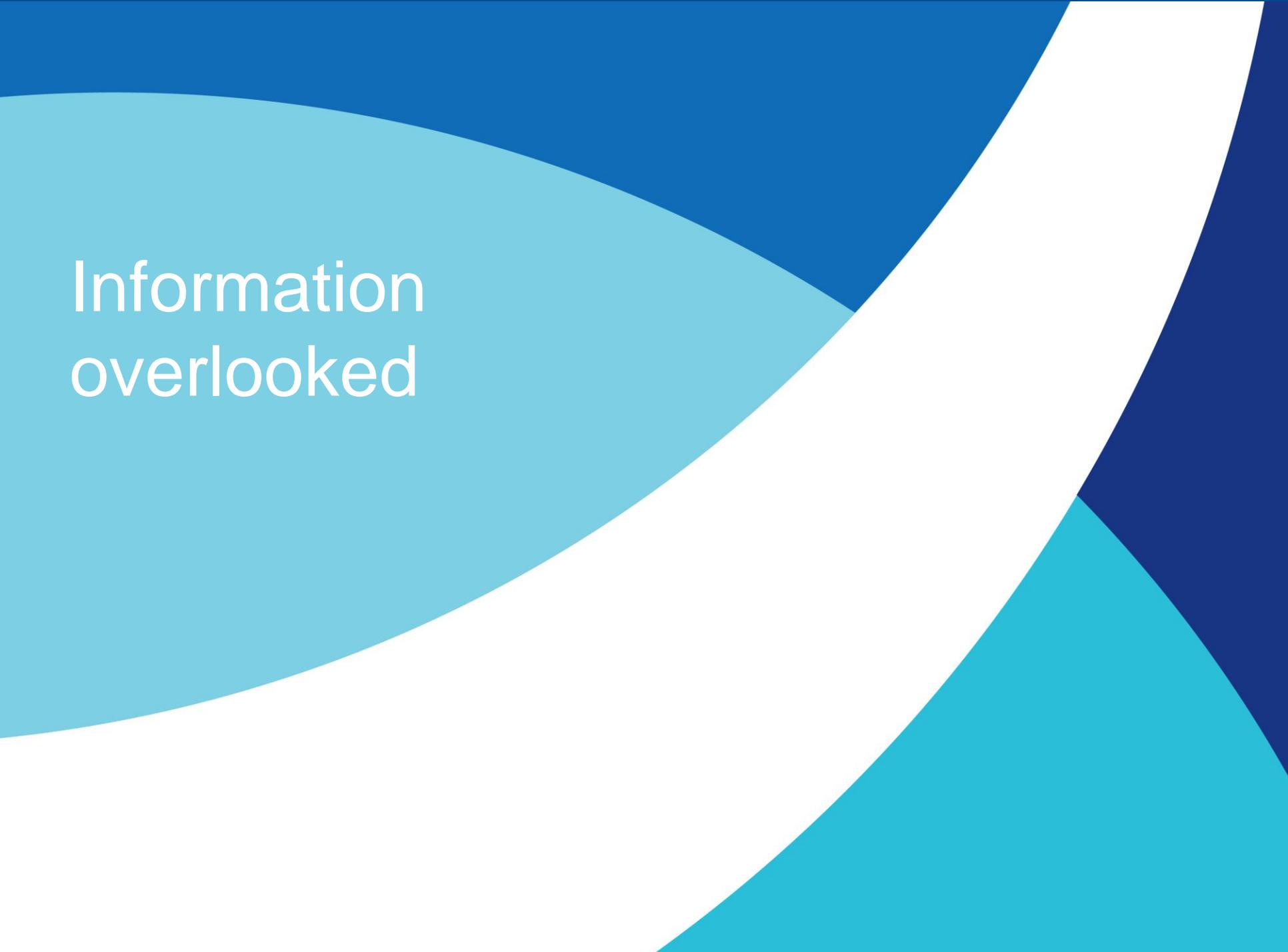
- AER approved ME for 2011-15: AA RIN Table 3.2, total escalated direct cost excluding total OH and RPM.
- AER approved ME for 2016-20: AER DD Table 6-2, total escalated direct cost excluding total OH, \$15.17M direct OH which AER allocated to ME and no RPM.
- AER approved number of new connections for 2011-15: AA10-SA-74915E JGN 2010-2015 Prudent Capex Final Decision (Merits Review) v2AER.xls
- AER approved number of new connections for 2016-20: AER DD Table 6-9.

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Modelling
errors/issues

Modelling issues

- Marketing opex step change approved, however the associated connections not included in the ME forecasts
 - This results in an understatement of ME capex of approximately \$5.5M.
- Use of historical unit rates has resulted in implicit disallowance of material categories of costs
 - Zinfra management fee is not reflected in historical unit rates and therefore has been implicitly disallowed
 - Assumption that historical unit rates include direct overheads is incorrect (since April 2012), therefore material costs have been implicitly disallowed

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Information
overlooked

Zinfra margin information overlooked

- Zinfra management fee margin explicitly disallowed:
 - “JGN did not set out why a Zinfra margin is incurred or how the margin is calculated” (page 6-26)
- Zinfra arrangements, including the management fee margin, were described and justified in:
 - a presentation to AER staff on 22 November 2013
 - JGN’s response to AA RIN clause 9 and supporting documents which included the FSA itself
 - AAI appendices 4.1, 4.2 and 6.8
- Was this information overlooked?

Summary

- We have some fundamental concerns with the draft decision on ME capex
- It is a complex area, so we think there is value in trying to work through as many issues as possible prior to our revised proposal
- We will continue to work through the detail and would like to reconvene on this in early January 2015

Questions?

Appendix

The background features a dynamic composition of curved, overlapping shapes. A large, light blue shape occupies the left side, while a white shape curves from the bottom left towards the top right. Darker blue and teal shapes fill the remaining spaces, creating a modern, abstract aesthetic.

JGN approach by connection category

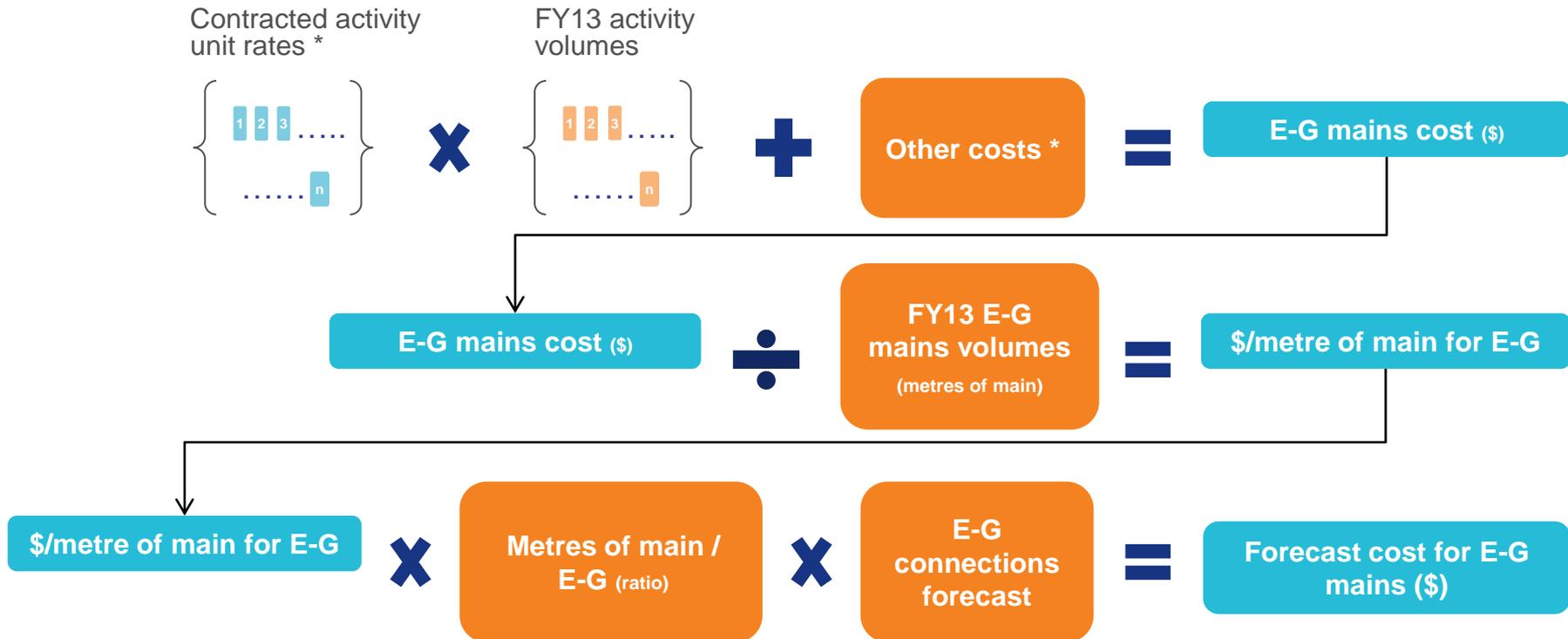
E-G capex

New estates capex

Medium / high-density capex

I&C tariff market capex

Example: E-G mains capex forecast



* Other costs include traffic management, restoration costs, contractor supervision and management.

Forecast ME expenditure by connection category – AER draft decision

- Calculation for each of 3 components—mains, services and meters—for each connection category



- Forecast component costs for the connection category are summed to produce the total forecast cost for the category

Unit rates below those previously approved

Comparison 2016-20 DD rates v AER approved 2011-15 rates

	\$2015	DD 2016-20	AER approved 2011-15	Variance	Sense check
Mains					
E to G			[c-i-c]		●
New estates routine					●
I&C routine					●
Medium density routine					●
Services					
E to G					●
New estates routine					●
I&C routine					●
Medium density routine					●
Meters					
E to G					●
New estates					●
I&C					●
Medium density					●